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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 208

TRANSPARENT-WRAP MACHINE CORPORATION,
Petitioner,

v.

STOKES & SMITH COMPANY,
Respondent.

PETITIONER'S REPLY TO RESPONDENT'S BRIEF

R. MORTON ADAMS,
for Petitioner.

W. B. MORTON, JR.,
of Counsel.

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PETITIONER'S REPLY TO RESPONDENT'S BRIEF

Re Respondent's Point I

Respondent's contention that there should be established by this Court a special rule for patent owners making it illegal to acquire patents as an incident to a patent license is unsound and unsupported.

The reason advanced by respondent as to why it should not be held to its agreement is that there should be a special rule whereby an otherwise legal agreement for acquisition of improvement patents becomes illegal merely because the agreement is included as part of a patent license.

Respondent does not in any way suggest that the transaction between the parties is, in its nature, object or effect, in any way violative of public policy or contrary

to law (it plainly is not, as was recognized by both courts below) or that an agreement to acquire patents is in itself in any way illegal (as it plainly is not, being specifically authorized by Statute, 35 U. S. C. 47). Respondent's contention is that such a legal agreement becomes illegal merely because it is included in a patent license. If such a doctrine is to be established by this Court, it will be without precedent in the statutes, in the decided cases, or in legal principles.

The view of respondent, and the majority of the court below, that such a doctrine can be derived from the so-called *Carbice* and related cases misconceives the fundamental basis on which those cases proceed, namely, that the practices there involved were *per se* contrary to public policy and the general law as being in restraint of trade.

1. The so-called *Carbice* Doctrine does not apply

In all of the so-called *Carbice* cases the practices involved were *per se* illegal restraints of trade and the holding of this Court was, as in anti-trust cases involving similar restraints of trade, that the illegal conduct could not be justified by the patent laws. In the present case, on the contrary, the conduct, namely, the assignment and acquisition of patents is *per se* authorized by statute, and there is nothing illegal that requires justification. Although the *Carbice* cases held that illegal conduct could not be justified by the patent law, there is nothing in them to warrant any conclusion that conduct in itself perfectly legal becomes illegal merely because it is a provision in a patent license. Such a doctrine would lead to the absurd result that patent owners, merely because they are patent owners and grant licenses, are deprived of rights under the general law which belong to all members of society.

Respondent bases its contention on selected language that it finds in some of the so-called *Carbice* decisions.

From this language, rather than the substance of the decisions, respondent deduces an incorrect "underlying principle" namely that (p. 9) "a patent owner may not use his patent to create or maintain a monopoly other than, different from, or outside of the scope of the monopoly defined by the patent itself." Respondent, in unsoundly ignoring the substance of those decisions, ignores an essential part of the doctrine which this Court has been very careful to state, *namely that the monopoly thus denied is one*

> "*not granted by the Patent Office and which it is contrary to public policy to grant.*"[1]

In the present case, the "monopolies" we are talking about are patents and are, beyond doubt, monopolies granted by the Patent Office and ones which, very plainly, it is public policy to grant. The only question in the present case is which of the two parties shall own them. Irrespective of who owns them the public cannot infringe them and no rights are therefore taken from the public.

In the present case there is no restraint of trade or other illegal conduct as in the *Carbice* cases and the so-called *Carbice* doctrine is thus irrelevant as we pointed out and discussed at length in our main brief (pp. 33 to 39) and have also pointed out in our reply to the Government brief.

The present issue should not be confused and beclouded by respondent's conjuring up allegedly dire consequences of acquisition of patents which respondent says (page 11) "conceivably" might occur. Those conditions do not exist in this case and if they ever exist in any other case, we assume that they will be dealt with on their merits as is

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[1] *Morton Salt Co.* v. *G. S. Suppiger Co.*, 314 U. S. 488, 492 (1942).

customary in the law and as was done in the *Hartford-Empire* case.[1] (See our reply to the Government brief, pp. 6-10.)

Nor should the issue be confused and beclouded by respondent's assertion that such a clause would destroy incentive to invent when in fact it would not, and did not (see our main brief, p. 20, and our reply to the Government brief p. 10).

Such an argument does not fairly lie in the mouth of one such as respondent who in fact did invent and who was placed in a position by petitioner where it, instead of petitioner, was the one who had the opportunity to note possible defects and the need for improvement and who, moreover, procured the transfer of the business from petitioner on a representation that it would be better equipped than petitioner to make improvements. Moreover, respondent, who shared in the profits of the business and had every pecuniary reason, as well as obligation, to promote the business and keep it ahead of competition, would have every incentive to invent. It would have even more incentive to invent than an employee—and employer-employee contracts for assignment of improvements have been consistently held valid. *Guth* v. *Minnesota etc. Co.* (C. C. A. 7th, 1934), 72 F. 2d 385 and cases there reviewed.

Nor should it be confused and beclouded by the argument of hardship on respondent. Respondent was a free agent and in fact sought the agreement and held out, as one of its inducements, its willingness and ability to make improvements. Moreover, there is no hardship in fact. The payments to be made by respondent are adjustable to all selling conditions and at all times according to a formula which shares the residual profit after giving respondent full costs of production, overhead, selling expense and

[1] *Hartford-Empire Co.* v. *United States*, 323 U. S. 386 (1945).

normal manufacturing profit. That such division of profits may continue after the original patents expire is no hardship but is an eminently fair part of the consideration between the parties. It is, in fact, less burdensome than an unconditional agreement to share all profits of the business in the future which would have resulted had there been a division of stock in a corporation or a partnership agreement. Moreover, respondent could terminate the agreement at the end of any five-year period; for example, if, after the original patent expired, respondent felt that the improvement patents were not worth enough to warrant continued sharing of profits with petitioner it would be perfectly free to end the agreement, turn the business back to petitioner, and enter upon the manufacture of the machine as previously covered by the expired patents without any payment to petitioner whatsoever. The fact that it could not infringe the improvement patents in so doing, results from its bargain and is no different than if it had sold the improvement patents for any other consideration.*

Respondent argues that paragraph 12 may be construed to cover inventions which are not improvements applicable to the Transwrap machine. This would not be significant if true, but it is not true. The agreement relates to "improvement which is applicable to the Transwrap Packaging Machine and suitable for use in connection therewith" (Par. 12, R. 100). The court below based its decision on the assumption that the inventions were in fact improvements of the basic machine covered by the existing patents.

Respondent quoting from the Government brief in the *Hartford-Empire* case urges that the patent laws do not justify a requirement that one company pay royalties

* On a par with its other arguments of hardship is respondent's argument concerning the tools. It is surely proper to provide for depreciation of tools—they do wear out. And the formula for pricing them for sale back to petitioner was the same as the formula applying to sale to respondent (Par. 8 (c) and (d), R. 97).

to another for the use of its own inventions. This seems quite irrelevant to our present discussion particularly when the Government brief in that case is examined and it is seen that the agreement there discussed was a complicated agreement forming one element in a conspiracy to violate the anti-trust laws.

2. The *Hartford-Empire* case recognized such a provision to be legal.

Respondent challenges our statement that this Court in the *Hartford-Empire* case recognized that it is *per se* legal to include in a license agreement a provision that licensee assign improvements to licensor. This is challenged so flatly that we feel warranted in presenting somewhat more in detail what happened in the *Hartford-Empire* case.

The trial court had found the defendants guilty of violating the anti-trust laws by, among other means, manipulating patents, and the trial court thereupon entered a sweeping decree and injunction. On the first argument before this Court, the parties argued the merits of the case and the justification for the decree. This Court held against the defendants on the merits and ordered reargument with respect to the decree alone. The parties thereupon briefed this separate matter, taking up the decree paragraph by paragraph and subparagraph by subparagraph.

One subparagraph, namely Paragraph 29 (e) prohibited granting any license which included a restriction that licensee assign improvements to licensor. The issue squarely presented to this Court was whether this broad injunction was proper.

The defendants argued that it was improper because the enjoined acts were *per se* clearly legal (Deft. brief, p. 129).*

* Joint Brief for Appellants on Reargument, p. 129.

The Government which had, in its main brief, justified the injunction solely on the ground of the past conspiracy and existing monopoly violating the anti-trust laws,* (pp. 377-8) thus recognizing that the provisions were *per se* legal, made the matter even clearer in its brief directed to the decree alone. In this brief,** at pages 153-4, the Government conceded that the injunction be limited to the field illegally monopolized, *thus leaving the parties free to use such a restrictive clause in other fields.* The Government conceded this field of legality, although it was fully aware of and discussed, on pages 157 and 158, the very cases now relied on by respondent, and discussed on page 165 (and pp. 225-7 and 246-7 of its main brief) the very arguments now advanced by respondent as to why such clauses in the hands of Hartford-Empire would operate contrary to the purpose of the patent system and the anti-trust laws.

With respect to this issue thus specifically presented, this Court, both majority and minority, ruled that the injunction was too broad and that it should be limited so as to permit the use of such a clause in fields other than those already illegally monopolized. Surely, if the use of such a clause is *per se* illegal, the Government would not have been warranted in conceding that there was any field in which it might be used.*** And, surely, no matter what the Government may have thought about it, if the use of such a clause is in fact illegal, this Court would not have thus countenanced its use.

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* Brief for United States (pp. 377-8): "Whatever may be the law with respect to contracts for the acquisition of improvement patents generally, *the employment of such agreements in support of an illegal licensing system, as here,* is in direct contravention of the constitutional purpose 'to promote the progress of science and useful arts.'" (Emphasis ours.)

** Brief for the United States on Reargument.

*** It is of interest to note that in the section of the Government's main brief, pages 227-239, where the Government was attempting to establish that the defendants "used *illegal* means to obtain the 'dominant' patents included in the pool", the Government did not make any mention of or suggest illegality of this clause.

3. Respondent's attempts to distinguish other cases cited by petitioner are not sound.

Respondent attempts to distinguish the *Allbright-Nell* case[1] on the ground that the licensor was there demanding the assignment of the licensee's interest in a *joint* invention. Respondent is not correct, however, in saying that, therefore the licensor was not trying to acquire a monopoly and that the case is thus distinguished. The law is well settled that joint owners may each manufacture under the patent and license others under the patent independently of one another.[2] The mere fact of joint ownership thus impairs the monopoly. When, in that case, licensor was demanding assignment of licensee's interest, it was attempting to acquire a monopoly just as fully as though it had been demanding assignment of a patent based on a sole invention.

It seems hardly fair to state, as respondent does, that the Seventh Circuit Court of Appeals did not understand the *Carbice* doctrine. It had applied that doctrine only a few months before; and the *Carbice* case, decided three years before, was itself an application, as it specifically stated,[3] of the doctrine of the *Motion Picture Patents case*[4] decided fifteen years before.

Respondent is clearly incorrect in its statement concerning the *Parker-Rust-Proof* case.[5] The decision there did not turn on the fact that patents were acquired as a con-

[1] *Allbright-Nell Co.* v. *Stanley Hiller Co.*, 72 F. 2d 392 (C.C.A. 7th, 1934).

[2] *Central Brass & Stamping Co.* v. *Stuber*, 220 Fed. 909 (C.C. 7th, 1915). See re difficulties resulting from joint ownership, *Coleman* v. *Whisnant*, North Carolina Sup. Ct. Oct. 31, 1945, 67 U. S. P. Q. 245.

[3] 283 U. S. 27 at 31.

[4] *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.*, 243 U. S. 502 (1917).

[5] *United States* v. *Parker-Rust-Proof Co.*, 61 F. Supp. 805 (E. D. Mich. S. D. 1945).

dition of a license and did not turn on the *Carbice* doctrine, but rather on the fact that (61 F. Supp. 805, 811) the acquisition of the patents "was intended to eliminate American as a competitor and it had that result" and was, therefore, contrary to the anti-trust laws.

Respondent attempts to distinguish the *Baker Oil Tools* case[1] on the ground that the licensor in that case was led to use licensee's patent attorney. This did not establish, but merely accentuated, the confidential relationship and joint interest in the success of the venture on which the court based its decision. The relationship of trust and confidence in the present case was plainly recognized by Mr. Stokes, president of respondent, when, in his letter emphasizing their research facilities as a reason why petitioner should entrust the business to them, he said, "as a suitor for your hand, it is rather a sporting proposition *to see whether we can win your confidence* against our rivals" (Ex. RF-1 R. 273, fol. 818).

Respondent attempts to distinguish the *American Refining* case,[2] by pointing out that licensee in that case had a residual shop right after it assigned the improvements to licensor. That case did not turn on that fact. But, though not so-called, respondent in this case has the same right, inasmuch as under the explicit terms of the agreement (Pars. 11 and 12) it has the reserved right to use the inventions in its normal business royalty free. In fact, it has more than a shop right in that it additionally has the right to license others for the same kind of business.

Respondent attempts to distinguish the *Sinclair Refining* case[3] on the ground of employer-employee relationship,

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[1] *Baker Oil Tools, Inc.* v. *Burch*, 71 F. 2d 31 (C. C. A. 10th, 1934).

[2] *American Refining Co.* v. *Gasoline Products Co.*, 294 S. W. 967 (Tex. Civ. App. 1927).

[3] *Sinclair Refining Co.* v. *Jenkins Petroleum Process Co.*, 99 F. 2d 9 (C. C. A. 1st, 1938).

but in that case the employee of licensor was not the one who made the claimed invention. The point of that case for present purposes is not, as respondent seems to think, that the licensor did not recover on the facts, but rather that the court there regarded the obligation as legal and enforceable if supported by the facts.

4. Respondent is incorrect in asserting that the business was not transferred to respondent to be operated for the benefit of both petitioner and respondent.

Respondent enters upon a lengthy, but by no means complete, analysis of the agreement between the parties in an attempt to negative the fact that petitioner transferred its business to respondent and that respondent undertook to operate the business for their joint benefit. We therefore note herewith those aspects of the agreement which clearly establish the affirmative.

a. Paragraph 1 not only gave respondent the exclusive right to manufacture and sell throughout the United States, Canada, and Mexico but specifically excluded petitioner. A separate letter (R. 46, fol. 138) transferred the right to use the trade-mark "Transwrap" which was an incident to the goodwill of the business.

b. Paragraph 5 provided that the petitioner would contribute the benefit of its experience in the manufacture and sale of the machines, would give complete information as to machines already sold, furnish any inquiries from any prospective customers, and supply the names of likely customers.

c. Paragraph 8 provided for petitioner's sale to respondent of all the jigs, fixtures, patterns used in the business in making the machines and also for the sale of any existing, already manufactured machines, or parts manufactured and ready for assembly into machines.

d. Paragraph 13 provided that respondent, having taken over the business, would honor commitments already made for machines to be installed in the plant of the Borden Company and also honor orders placed by Henry Heide, Inc. and also would honor orders by petitioner to secure machines to sell in foreign fields.

e. Paragraph 6 provided that respondent would use its best efforts to promote the manufacture, market and sale of the machines.

f. Paragraph 4 provided that the payments to petitioner by respondent were to be flexible and dependent upon manufacturing and marketing conditions and to consist of an equal division of the residual profits after insuring payment to respondent of its manufacturing costs, overhead, normal manufacturing profit and sales expense, it being hoped that the parties, on the basis of this formula, would be able to agree from time to time on a fixed sum per machine.

g. Paragraph 9 provided for joint effort and cooperation should any infringement suit be brought against the business and that any costs and damages would be equally shared. Also, this paragraph provided that, in the event of suits to restrain unauthorized sale or manufacture under the Transwrap patents, the recovery would be equally divided.

h. Paragraphs 11 and 12 provided that all patents relating to the Transwrap machine, whether originating with petitioner or respondent, would be made available for the benefit of the business, and due recognition was given to petitioner's foreign interests and also to respondent's other business.

Re Respondent's Point II

Respondent's contention of severability not supported by the facts.

Respondent asserts that an agreement cannot be cancelled for failure to comply with an illegal provision and with this, of course, we agree, but we do not see any application to the present case. We think the breached provision is legal, and hence, that the agreement may be cancelled because of the breach.

Respondent's brief (p. 27) makes the wholly unwarranted suggestion that petitioner was waiting for the most opportune time to take advantage of respondent by cancelling the agreement and that it used the patents merely as an excuse, but the facts are quite the contrary—not only was respondent given full opportunity to remedy its default but respondent twice wrote (Exhs. M and N, R. 287-8) stating that it would remedy the default and changed its mind only at the last minute and filed the present suit without any notice to petitioner.

Respondent really advances this argument in the hope that, if the clause be held illegal, respondent will escape part of its just obligations and yet be able to retain all the benefits. To this end, it argues that the obligation to disclose improvements was severable. However, the circumstances, established by unchallenged documents (Exh. F-1, F-2; R. 273, 278) surrounding the making of the agreement, such as respondent's representation that it had superior facilities for making improvements, negative any such thought. Severability is a question of fact peculiar to each case (*U. S.* v. *Bethlehem Steel Corp.*, 315 U. S. 289, 298; 1942). Mr. Zwoyer, who negotiated the agreement, testified at the trial as to the surrounding circumstances and as to the fact that this obligation of paragraph 12 was an essential part of the consideration (R.

65-66)*. Respondent made no attempt to contradict or rebut this and it must be presumed that its testimony would have confirmed it.

In support of its argument, respondent brings in, with erroneous implications and distorted emphasis,** some of

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* "Q. Let me ask you whether the fact that Stokes & Smith represented that it was in a position to make developments of the Transwrap machine and inventions relating to that was an essential factor in making the deal with Stokes & Smith? A. It was definitely a factor in making the deal. Mr. Stokes had made it very clear to us, and took us through his factory and showed us various pieces of equipment on which he was spending a lot of money developing, and showing he had a department in which he could develop the Transwrap machine and improve whatever parts might require improving.

"Q. Were these provisions relating to Transwrap improvements or the inclusion of the improvements in the license which are covered by clauses 11 and 12; were they essential parts of the deal? A. They were definitely essential parts of the deal."

** No "list of various improvements" was submitted by Exhibit 6 (R. 233, off'd R. 69) as respondent asserts. This is a letter which, by its own terms, contains merely "suggestions" and "possible ideas" that might be developed, without any disclosure of means for accomplishing them (Zwoyer R. 72, fol. 215). The conversations which respondent refers to, confirm this.

Exhibit 7 (R. 235, off'd R. 81) refers to an invention made by petitioner, not one made by respondent.

Exhibit K (R. 280) did not advise that the patent referred to was an improvement on the Transwrap machine.

Exhibit L (R. 281) was a letter arguing for royalty reduction and, although it emphasized their policy of research and the cost thereof, did not advise that any of the inventions of the patents here involved had been made—though we now know that some of them had not only been made but that respondent had, without notice to petitioner, applied for patents on them.

Concerning the knowledge of petitioner's patent attorney, the trial court said (R. 301): "Just what this testimony amounts to is difficult to determine and it was the plaintiff's obligation to have it clarified * * *"

Zwoyer testified (Zwoyer R. 57, fol. 169) respondent never disclosed that any inventions were completed and ready for patenting (R. 56-7, fols. 168-9; R. 58, fol. 172) or that applications were being applied for by respondent (R. 77, fol. 231); also, (R. 59) that he had no recollection of any one ever calling any such patents to his attention prior to 1944 when he called the default to the attention of Stokes & Smith. He had no reason to suspect respondent of working contrary to petitioner's interest; he thought they were cooperating (R. 56) and had no reason to think respondent would not continue in the business in the joint interest.

the facts produced at the trial in order to support a contention of laches and estoppel. This issue, however, is not before this Court, was not urged before the Court of Appeals, and was squarely resolved against respondent on the facts by the trial court. The trial court found as a fact (R. 296, fol. 887):

> "The defendant has not been guilty of laches nor has anything done or omitted by it established any estoppel."

and in its opinion held (R. 301, fol. 902):

> "There is not a whit of evidence to sustain either of these defenses"

and (R. 299, fol. 896):

> "We find on the evidence that the plaintiff never at any time made any offer to meet its contract obligation to submit discoveries or inventions to the defendant."

Re Respondent's Point III

The judgment of the Trial Court should be affirmed

We agree that there is no need of the further proceedings in the trial court suggested by the court below. We differ with respondent, however, as to the disposition to be made of the case. Respondent's suggestion that, if the clause were to be held illegal, respondent should be allowed to keep the benefits of the agreement while escaping an essential part of its obligations, is unsound and unjust. Under such circumstances the whole agreement would fall and the license and respondent's right to continue in the business would cease. The license here was mere forbearance from suit and was not a vested interest in the patent. *Waterman* v. *Mackenzie*, 138 U. S. 252, 256 (1891).

We think it clear that the challenged clause is legal and enforceable, that respondent breached the agreement by withholding the improvements and refusing to remedy its default, and that the Trial Court was correct in so holding and it should be affirmed.

Respectfully submitted,

R. MORTON ADAMS,
for Petitioner.

W. B. MORTON, JR.,
of Counsel.